COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Boston Gas Company	)	D.P.U./D.T.E. 96-50-D (Remand)

COMMENTS OF BOSTON GAS COMPANY
REGARDING REMAND PROCEEDINGS IN D.P.U./D.T.E. 96-50-D

I. INTRODUCTION

On October 27, 2000, the Department of Telecommunications and Energy (the "Department") requested comments regarding how to proceed with the remand from the Supreme Judicial Court (the "Court") in Boston Gas Co. v. Department of Public Utilities, SJC-07970 (August 13, 1999). In that case, the Court vacated and remanded two portions of the performance-based regulation ("PBR") plan of Boston Gas Company ("Boston Gas" or the "Company") approved by the Department in Boston Gas Co., D.P.U. 96-50 (Phase I) (1996) (the "Order") and Boston Gas Co., D.P.U. 96-50-C (1997) (collectively, the "Orders").[1] Specifically, the two factors remanded were: (1) the inclusion of an "accumulated inefficiencies factor" of 1.0 percent in the productivity offset; and (2) the enlargement of the contingent annual service quality adjustment from $1.0 million to $4.9 million.

As discussed below, the Department has discretion to determine how to proceed with its consideration of the issues that are the subject of the Court's remand order. In this case, the issues have been remanded to the Department because the Department failed to make requisite factual findings in its Orders to support certain components of the price-cap formula. There is no

[1] On November 29, 1996, the Department issued the final order in the Company's base rate proceeding, (D.P.U. 96-50 (Phase I)). On December 19, 1996, the Company filed a Motion for Reconsideration, Clarification and Recalculation (the "Motion") with the Department requesting reconsideration of certain issues resolved by the Department in that decision. On May 16, 1997, the Department issued a further order in the proceeding that granted in part, and denied in part, the Company's Motion, D.P.U. 96-50-C.

question that, with regard to the initial proceedings, all parties have had the opportunity to litigate the issues surrounding the composition of the productivity offset to the PBR price-cap formula, including the inclusion of the accumulated inefficiencies factor, and the service quality penalties. Therefore, because the issues that are the subject of the remand were fully litigated during the initial proceeding, there is no basis to justify the re-opening of the record in this case. Rather, the Department should evaluate the existing record to determine whether there is substantial evidence to support the accumulated inefficiencies factor, as well as an increase in the size of the service-quality penalties. As set forth below, the record for this proceeding allows for no such demonstration.

II. FACTS AND PROCEDURAL HISTORY

On November 30, 1996, the Department issued its initial determination approving a PBR Plan for the Company that would adjust base rates on an annual basis to reflect the impact of inflation less a productivity factor. Order at 273-284. In this initial Order, the Department established a productivity factor of 2.0 percent, which was composed of a consumer dividend factor equal to 1.0 percent and an accumulated inefficiencies factor of 1.0 percent. Id. at 283. The Department subsequently reduced the consumer dividend factor to 0.5 percent. D.P.U. 96-50-C at 58.[2] In addition, the Department ordered the Company to include in the PBR

[2] The result, including the amended consumer dividend, is calculated as:

$$X = (TFP_{(NEgas)} - TFP_{(US)}) - (IP_{(NEgas)} - IP_{(US)}) + CD + \text{accumulated inefficiencies}$$

$$X = (0.4 - 0.3) - (3.7 - 3.6) + 0.5 + 1.0 = 1.5.$$

See D.P.U. 96-50, at 284 n.130.

Plan a potential annual penalty of $4.9 million if certain service quality performance measurements fell below historical levels. Order at 310.[3]

Boston Gas appealed the inclusion of the accumulated inefficiencies factor and the imposition of the $4.9 million service-quality penalty to the Court. On August 13, 1999, the Court issued an order on the Company's appeal that vacated and remanded to the Department for further proceedings "those portions of the Department's Orders in DPU 96-50 and 96-50-C" that address the following two issues: (a) the inclusion of an accumulated inefficiencies factor in the Company's price-cap formula; and (b) the enlargement of the maximum contingent annual service-quality penalty. Boston Gas Co. v. Department of Pub. Utils., SJC-07970, at 1-2 (August 13, 1999). The Court issued its order upon consideration of the Department's Motion for Discharge of Report and Remand, and the Company's response thereto, which acknowledged the continued operation of the Company's PBR Plan. Accordingly, the Company developed and filed rate tariffs for effect in both 1999 and 2000, in compliance with the price-cap formula established by the Department in D.P.U. 96-50, as modified by the Court.

III. ARGUMENT

A. The Department Is Not Required To Re-Open the Record in This Remand Proceeding.

As a general matter, courts provide agencies wide latitude in determining how to conduct remand proceedings. When the remanding court vacates the decision of an agency and does not specifically order an agency to reopen the record, the agency may determine whether to proceed on the basis of evidence presented at the earlier hearing or to rehear the case regarding the specific issue remanded. See, e.g., Point of Pines Beach Assoc. v. Energy Facilities Siting Bd.,

[3] The Company had proposed a service-quality system with a maximum monetary quantity of $1.0 million

419 Mass. 281, 287 (1995); Attorney Gen. v. Energy Facilities Siting Bd., 419 Mass. 1003, 1005 (1995); Holyoke St. Ry. Co. v. Department of Pub. Utils., 347 Mass. 440, 450 (1964); Adams v. Contributory Retirement Appeal Bd., 33 Mass. App. Ct. 171, 175 (1992), *rev'd on other grounds*, 414 Mass. 360, 364, n.4 (1993); Lion Distribs., Inc. v. Alcoholic Beverages Control Comm'n, 15 Mass. App. Ct. 988, 990 (1983); Atkinson's Inc. v. Alcoholic Beverages Control Comm'n, 15 Mass. App. Ct. 325, 326-327 (1983); Charlesbank Restaurant, Inc. v. Alcoholic Beverages Control Comm'n, 12 Mass. App. Ct. 879, 880 (1981); Sniffin v. Prudential Ins. Co. of America, 11 Mass. App. Ct. 714, 722 (1981).

Conversely, when the Court gives explicit direction to an agency to take a particular course of action, the agency must follow that instruction. For example, in Boston Edison Company v. Department of Public Utilities, the Court vacated the Department's decision and explicitly ordered the record to be reopened so that the Department could receive and consider new evidence regarding the specific subject of the remand. 419 Mass. 738, 749 (1995) (stating "[w]e are persuaded that it is necessary for the [D]epartment to reopen the record so that it can receive and consider evidence whether the deferral of Edison's proposed generating plant has resulted in a contract price well in excess of avoided costs"). Also, in Massachusetts Institute of Technology v. Department of Public Utilities, the Court explicitly directed the Department to:

> at a minimum provide us with a statement of reasons, including subsidiary findings, why it accepted the company's calculation of stranded costs in light of the conflicting testimony (and why it rejected MIT's challenges to each of the component parts of the calculation); why an allocation of 75% of those costs to MIT was not arbitrary; why it concluded the stranded costs for which the company seeks reimbursement through the CTC were prudently incurred (and why it rejected claims by MIT, the Attorney General and the city that the costs were not prudently incurred); and what, if any, steps the company undertook to "aggressively mitigate" its costs, particularly in light of the advance notice that it

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per year. Order at 297.

> had of MIT's departure. It should, in short, provide us with a decision on the basis of which we will be able to conduct our appellate review.

425 Mass. 856, 875 (1997); see Boston Gas Co. v. Department of Pub. Utils., 405 Mass. 115, 116 (1989). Thus, the Court can impose, and frequently does impose, specific requirements upon an agency with respect to the conduct of a remand proceeding.

When the Court does not give an agency explicit directions for the conduct of a remand proceeding, the agency retains the discretion to make its decision on the basis of the existing record without an obligation to conduct additional hearings. See, e.g., Point of Pines, 419 Mass. at 287 (stating "[w]e leave any question concerning a reopening of the board's hearings to the discretion of the board"); Attorney Gen. v. Energy Facilities Siting Bd., 419 Mass. at 1005; Holyoke St. Ry. Co., 347 Mass. at 450; Adams, 33 Mass. App. Ct. at 175 (1992); Lion Distribs., 15 Mass. App. Ct. at 990 (stating "[i]n its discretion, the commission may proceed on the basis of the evidence presented at the earlier hearing, or it may rehear the case insofar as a violation of [a specific statutory provision] is alleged"); Atkinson's, 15 Mass. App. Ct. at 326-327; Charlesbank Restaurant, 12 Mass. App. Ct. at 880; Sniffin, 11 Mass. App. Ct. at 722. Cf. MIT, 425 Mass. at 875; Boston Edison, 419 Mass. at 749.

Specifically, a remand by the court for "further proceedings" before the agency, is considered to be a general directive and does not impose a requirement upon the agency to conduct additional hearings. See Adams, 33 Mass. App. Ct. at 175 (stating that, based on a remand for "further proceedings," the agency "chose not to hold further hearings (nor was it required so to do)"); Adams v. Contributory Retirement Appeal Bd., 26 Mass. App. Ct. 1032, 1036 (1989) (remanding the case to the agency for "further proceedings"). In the instant case, the Court vacated the Department's order and remanded the issue of accumulated inefficiencies to

the Department for "further proceedings." Boston Gas Co. v. Department of Pub. Utils., SJC-07970, at 1-2 (August 13, 1999). There was no specific directive in the language of the Court's remand order requiring the Department to take a particular course of action. Accordingly, the Department is not required to conduct additional hearings and take new evidence and may issue a decision with adequate findings of fact based on the existing record.

B. The Department Should Not Re-Open the Record Because the Issues of Accumulated Inefficiencies and Service Quality Adjustments Were Litigated Fully in the Original Proceeding.

There is no dispute that the parties in the initial proceeding had the opportunity to litigate issues relating to the composition of the productivity offset, including the application of an accumulated inefficiencies factor, and the magnitude of potential service-quality revenue penalties. Reopening the record at this time will only have the effect of allowing the parties to relitigate issues that previously have been investigated and decided by the Department, which is inconsistent with long-established Department precedent. See, e.g., Massachusetts Elec. Co., D.P.U. 95-40-C at 21 n.19 (denying a "request to conduct a separate investigation into the circumstances that led to the allocation methodology used by the Company" because it was "an attempt to reargue an issue considered and decided in the main case"); Boston Edison Co., D.P.U. 90-270-A at 3 (1991) (stating "[a] motion for reconsideration should bring to light previously unknown or undisclosed facts that would have a significant impact upon the decision already rendered. It should not attempt to reargue issues considered and decided in the main case"); Western Massachusetts Elec. Co., D.P.U. 84-25-A at 6-7 (1984).

Further, the Department recognizes reasonable time limitations in determining whether to reopen the record in a proceeding. New England Tel. and Tel. Co., D.P.U. 87-AD-12-B, at 4 (Aug. 10, 1990) ("[t]he Department acknowledges that the regulation does not contemplate the

reopening of a case some three years after the close of the record"); New England Tel., D.P.U. 90-308-B at 3 (Aug. 31, 1992) (denying a motion to reopen as untimely because it came several months after the expiration of the appeal period). Opening the record to consider these issues now would be highly impractical for the following reasons: (1) the Department would be re-assessing the underpinnings of a five-year PBR plan that is currently in its fourth year; (2) the parties would be introducing evidence of past, not present, circumstances that would require a retrospective review of a number of factors relating to the Company's operations and then-prevailing market conditions; and (3) even if such inefficiencies were demonstrated, the Department has recognized that such inefficiencies are "effectively weeded out" over time by operation of a PBR plan. D.P.U. 94-50, at 167, n.99 (stating "[a]fter the Company has been operating under price cap regulation for the first six-year term . . . we expect that the weeding out of accumulated inefficiencies would be completed, and future productivity offsets may be adjusted downward to compensate"). Because the parties in this proceeding had the opportunity to litigate these issues and to establish a record to support the imposition of an accumulated inefficiencies factor at the time the analysis might have been relevant, there is no basis for a reopening of the record at this juncture.

Furthermore, the Department's own regulations and case law would preclude a re-opening of the record. Department regulations state that "[n]o person may present additional evidence after having rested nor may any hearing be reopened after having been closed, except upon motion and showing of good cause." 220 C.M.R. § 1.11(8). Good cause for purposes of reopening has been defined as a showing that the proponent has previously unknown or undisclosed information regarding a material issue that would be likely to have a significant impact on the decision already rendered. New England Tel. and Tel. Co., D.P.U. 87-AD-12-B at

4-7 (1990); Boston Gas Co., D.P.U. 88-67 (Phase II) at 7 (1989); Tennessee Gas Pipeline Co., D.P.U. 85-207-A at 11-12 (1986). In this case, there are no "previously unknown facts or undisclosed information" that would warrant a reopening of the proceeding.

Thus, the current circumstance is not like the situation in Boston Edison Co. v. Department of Public Utilities where the Court first remanded the case without instruction and then, upon an appeal of the Department's remand proceedings, explicitly redirected the Department to take additional evidence. 419 Mass. at 749. In that case, the Court initially remanded the case for "further consideration" by the Department. 417 Mass. 458, 466 (1994). In response to the first remand, the Department determined that the existing record adequately supported its statement of reasons. Boston Edison Co., D.P.U. 92-130-B at 9 (1994). This determination was challenged for the failure to consider whether "truly extraordinary circumstances" existed warranting a reopening of the record. 419 Mass. at 742. In the second remand proceeding, the Court found that the traditional notion of deference to an agency's evidentiary decisions was not due because the Department's existing record did not supply adequate support for the agency's decision. Id. at 749.

The key difference between the current case and Boston Edison is that, in the initial proceeding in D.P.U. 92-130, the Department made a determination to exclude evidence, which was offered by a party to the proceeding on the matter that, ultimately, was the issue of the remand. Id. at 743-44. On appeal, the Court determined that the Department's final decision was not supported by the record because the Department had excluded relevant evidence. Id. at 749. On remand of its initial decision, the Department reached a determination on the issues identified by the Court without reopening the record to allow for the introduction of the excluded evidence. D.P.U. 92-130-B at 9. In response to a second appeal, the Court remanded the case

with explicit instructions to "receive and consider evidence whether the deferral of Edison's proposed generating plant has resulted in a contract price well in excess of avoided costs." 419 Mass. at 749.

The case at hand is unlike Boston Edison in that the Department fully considered the issue of accumulated inefficiencies and service quality adjustments in the initial proceeding and accepted any evidence offered by the parties on that issue. The Department is not faced with the need to reopen the record to allow a party to provide previously unaccepted evidence or to clarify an issue that was not fully litigated. Therefore, re-opening the record would serve only to allow parties a second chance to present evidence on accumulated inefficiencies where a full and fair opportunity to present such evidence was provided in the original proceeding.

C. The Record Does Not Support the Imposition of Accumulated Inefficiencies.

1. Standard of Review.

In order for the Department's Orders to be sustained, the Department's determinations must be based on substantial evidence. G.L. c. 164, § 14(7)(e); MIT, 425 Mass. at 867-868; Martorano v. Department of Pub. Utils., 401 Mass. 257, 261 (1987); Costello v. Department of Pub. Utils., 391 Mass. 527, 539 (1984). Substantial evidence is defined as evidence that "a reasonable mind might accept as adequate to support a conclusion." G.L. c. 30A, § 1(6); Martorano, 401 Mass. at 261, n.5. Without substantial evidence supporting a factual finding, the Court will reverse a decision as arbitrary and capricious or otherwise not in accordance with law. G.L. c. 30A, § 14(7) MIT, 425 Mass. at 868.

The Court will accord deference to the Department's decisions where it has provided an adequate statement of reasons to support its findings including a determination of each issue of fact or law necessary to the decision. G.L. c. 164, § 11(8); MIT, 425 Mass. at 867-868; Hamilton

v. Department of Pub. Utils., 346 Mass. 130, 137 (1963). The Court has emphasized the need for a reasonable explanation in support of any decision: "[a]bsent such a statement of reasons, [the Court is] unable to determine whether an appellant has met his burden of proof that a decision of the Department is improper." Costello, 391 Mass. at 533. In such circumstances, an order must be reversed or, at a minimum, remanded to the agency. See, e.g., Boston Edison, 419 Mass. at 748-49.

2. There Is No Substantial Evidence To Support the Imposition of an Accumulated Inefficiencies Factor.

The imposition of the accumulated inefficiencies factor requires the Department to make findings of fact based on substantial record evidence. Although Boston Gas did not include an adjustment for accumulated inefficiencies in its proposed price-cap formula, the Department adopted its own accumulated inefficiencies factor of 1.0 percent as part of the productivity offset, based solely on a rationale borrowed from its decision in NYNEX:

> [We] find our acceptance of the underlying rationale for approving price cap regulation, i.e. that the average firm under price cap regulation will be more efficient than the average firm under ROR regulation, requires us also to find that there are accumulated inefficiencies in the Company's current operations that the Department was unable to discover in its earnings review and would be unable to discover in a traditional rate case.[4]

Order at 281-282, citing, NYNEX, D.P.U. 94-50, at 166-167 (emphasis added).

As discussed below, the Department's stated rationale for the accumulated inefficiencies factor, and the application of this rationale to the gas industry and to Boston Gas, in particular, is inconsistent with its concurrent finding that the Company's cast-off rates are just and reasonable,

[4] It is important to note that the NYNEX case was an "earnings review" case and not a traditional cost of service/rate of return ("COS/ROR") base-rate case. NYNEX, D.P.U. 94-50, at 167-168. Consequently, the NYNEX holding is clearly distinguishable from the instant case in that, in this case, the Department applied the accumulated inefficiencies factor while making the simultaneous determination that the Company's approved base rates under COS/ROR were just and reasonable.

and is also unsubstantiated by the record in this proceeding. Specifically, the record lacks support for four key findings that would be necessary to support the Orders: (1) that accumulated inefficiencies exist in the telecommunications industry; (2) that accumulated inefficiencies exist in the gas distribution industry; (3) that the inefficiencies in the telecommunications industry represent an "appropriate proxy" for the purported level of inefficiencies in the gas industry; and (4) that accumulated inefficiencies existing generally in the gas industry also exist in the operations of Boston Gas and are reflected in the "just and reasonable" rates established by the Department in the base-rate proceeding.

With regard to the first two findings, i.e., the existence of accumulated inefficiencies in the telecommunications and gas industries, the Department's Order relies exclusively on findings made in NYNEX, rather than evidentiary support in the record for this proceeding. In NYNEX, certain parties suggested that inefficiencies in NYNEX's operations were "evidenced by [NYNEX's] current process re-engineering initiative and other down-sizing programs." NYNEX, D.P.U. 94-50, at 166. The Department agreed that "it is likely that inefficiencies have accumulated and are contained in NYNEX's current rates." Id. With little support in the NYNEX record, the Department offered the following reasoning to support its conclusion:

> If the telecommunications industry has been operating less efficiently during the long-term period that is the foundation of the productivity offset, than it would have under price cap regulation . . . then there must be accumulated inefficiencies that should be accounted for in the first term of the price cap plan.

Id. In extending this concept to the price-cap formula proposed by Boston Gas, the Department concluded, without any underlying evidence, elaboration or analysis in the record, that "this rationale applies equally to companies that comprise the regulated gas distribution industry." Order at 281-282.

Thus, the record for this proceeding provides no evidentiary justification for the application of the accumulated inefficiencies factor to the gas industry, and to Boston Gas in particular. The sole basis for this finding is the assertion in NYNEX that unidentified inefficiencies resulting from traditional COS/ROR regulation exist and will be eliminated under price-cap regulation. A mere assertion that these inefficiencies somehow exist, without substantial evidence or subsidiary findings of fact, is insufficient to support application of the accumulated inefficiencies factor to the rates of Boston Gas. The Department acknowledged the lack of evidence supporting such a conclusion, stating that there is "little information regarding the efficiency improvements that should result as regulated companies move from cost-of-service regulation to performance-based regulation." Order at 282. Moreover, with respect to Boston Gas, the record evidence reflects that the Company's performance in minimizing costs exceeded the average performance of the natural gas industry on a regional and national basis (Exhs. BGC/MNL-3; BGC/ERB-3; Tr. 3, at 8-20; Tr. 16, at 78-82).

Without support in the record for a finding that accumulated inefficiencies actually exist in the gas distribution industry, the Department concluded:

> Both the telecommunications and gas distribution industries have operated under cost of service regulation for over 100 years. The Department finds that the finding in NYNEX regarding accumulated inefficiencies in the telecommunications industry is an appropriate proxy for the level of accumulated inefficiencies in the gas distribution industry.

Order at 283. The record, however, does not reflect any assumptions, data or analysis to support this conclusion.[5] Moreover, the Order further demonstrates the arbitrariness and the absence of a

[5] In fact, the Department has more extensive regulatory authority over the gas distribution industry than it does over the telecommunications industry. See, e.g., G.L. c. 164, §§ 69I et seq. Yet, there is no basis in the record to explain how accumulated inefficiencies developed in the gas distribution industry to the same extent as in the telecommunications industry despite the more extensive regulatory scheme that exists.

factual basis to support any conclusions on accumulated inefficiencies in that the Department explicitly recognized the dissimilarities between the telecommunications and gas industries, stating that "gas distribution utilities are not . . . subject to the same pace of technological innovation or competition as the telecommunications industry." Id. at 55-56. The Order offers no guidance on how the Department reconciled these contradictory conclusions and the record evidence provides no basis to buttress the Department's findings.

The record also fails to provide substantial evidence for the Department's finding that "the revenue requirement reflected in the Company's cast-off rates includes accumulated inefficiencies that must be taken into consideration in the price-cap formula." Id. at 282. The Department rejected the Company's contention that no accumulated inefficiencies existed in its operation based solely on the Department's unsupported conclusion in NYNEX that accumulated inefficiencies are reflected in the rates of all utilities subject to COS/ROR regulation. Order at 282. There is no basis in the record to support the application of the accumulated inefficiencies factor to the Company's cast-off rates in conjunction with a determination that the newly established rates are just and reasonable.[6]

[6] Significantly, in the absence of record evidence to support the finding that accumulated inefficiencies are reflected in the rates that the Department contemporaneously determined to be just and reasonable, the accumulated inefficiencies factor effectively double counts inefficiencies that serve as the basis for the imposition of the consumer dividend factor. That is, without a basis for differentiating the inefficiencies that are accounted for by the consumer dividend from those accounted for by the accumulated inefficiencies factor, there is no basis for imposing both factors. Notably, the Department states in its Order that, in determining the appropriate level of the consumer dividend that "predicting future productivity growth for Boston Gas is difficult . . . because so little information currently exists regarding the efficiency improvements that should result as regulated companies move from [COS/ROR] regulation to [PBR] regulation." Id. at 280. The Department next states, in determining the appropriate level of the accumulated inefficiencies factor, "as discussed above, there is little information regarding the efficiency improvements that should result as regulated companies move from [COS/ROR] regulation to [PBR] regulation." Id. at 282 (emphasis added). These statements explicitly acknowledge that there is no basis in the record to support imposition of both the consumer dividend and accumulated inefficiencies factor.

Therefore, with regard to the accumulated inefficiencies factor, there is no substantial evidence, or even any evidence in the record that "a reasonable mind might accept as adequate to support a conclusion." G.L. c. 30 § 1(6). Martorano, 401 Mass. at 261, n.5. Given the absence of record evidence to support the Department's findings in its first decision, on remand the Department must find that accumulated inefficiencies do not exist in the operations of Boston Gas.

D. The Record Also Does Not Support the Imposition of a Service Quality Adjustment.

1. The Department Lacked Authority To Expand the Service Quality Penalties Beyond What Was Proposed by the Company.

In directing companies to develop PBR plans, the Department stated that such plans should include measurable performance indicators and targets to evaluate a program's effect on safety, reliability and service quality. Order at 304; Incentive Regulation, D.P.U. 94-158, at 63-64 (1995). Accordingly, in response to this directive, Boston Gas proposed a comprehensive service-quality index ("SQI") as part of its PBR plan. Order at 293-297. Consistent with the Department's findings in NYNEX, the Company also proposed a financial incentive to ensure that service quality did not decline over the term of the PBR plan. Order at 293.

In its Order, however, the Department made substantial modifications to the Company's proposal, ultimately establishing an SQI composed of seven performance indicators: (1) response time to odor calls; (2) employee lost-time from accidents; (3) telephone service; (4) service appointments met when requested; (5) number of customer complaint cases before the Department; (6) customer bill adjustments ordered by the Department; and (7) meter reading. Order at 311.

For each of these indicators, the Department established a target level, or benchmark, based on high standards of performance within each service category. Id. at 303-309. The Department rejected the Company's proposal to establish a penalty of $200,000 for each percent that its actual performance were to fall below the benchmark index for a measurement period, up to a maximum penalty of $1,000,000. Id. at 297. Instead, the Department established a penalty level far in excess of that proposed by the Company, i.e., up to $700,000 for each of seven measures, for a total potential penalty of $4.9 million. Id. at 310. However, because the Department is not authorized to levy penalties, or to order reparations or rate rebates, the Department lacked authority to modify unilaterally the service-quality incentives proposed by Boston Gas. Instead, the Department could approve a service quality penalty only up to the amount proposed by the Company.

It is well-settled that a state regulatory agency derives its power from its governing statutes, which determine the procedural and substantive limits of the agency's authority. Commissioner of Revenue v. Marr Scaffolding Co., 414 Mass. 489, 493 (1993); see Massachusetts Electric Co. v. Department of Pub. Utils., 419 Mass. 239, 245-246 (1994). Absent such statutory authority, the regulatory agency may not act. Id. In construing the limitations of the Department's statutory authority, the Court has held that the Department is without jurisdiction to award monetary damages or reparations for alleged overcharges by a utility because such authority is not expressly conferred by statute. Metropolitan Dist. Comm'n v. Department of Pub. Utils., 352 Mass. 18, 26 (1967); see Southbridge Water Supply Co. v. Department of Pub. Utils., 368 Mass. 300, 310 (1975). The Court has further held that the statutory grant of authority to the Department to regulate and supervise the activities of a company subject to the Department's jurisdiction does not imply the power to impose a broad

system of rate rebates for inadequate service. City of Newton v. Department of Pub. Utils., 367 Mass. 667, 678-81 (1975). In making this finding, the Court emphasized that, "where the General Court has desired that the Department have the power to order any form of rebates it has expressed that intent by statutory enactment." Id. at 679-680.

The Department, without any such statutory authorization, converted the Company's proposal into a punitive fine that, if assessed, would severely penalize the Company for failing to meet unprecedented and unreasonably high threshold levels of service without any finding of unreasonable action or imprudence by the Company. Such a result was beyond the Department's authority in two respects.

First, no provision of the Department's governing statutes granted the Department the authority to impose such monetary penalties. The Department itself has recognized that, although it may have authority to impose a "range of sanctions" on utilities within its jurisdiction, a legislative enactment would be required to provide it with the authority to implement fines or penalties to enforce its regulatory policies. See Standards of Conduct, D.P.U. 96-44, at 14-15, n.8 (1996); accord City of Newton, supra, at 679-680. As a result, in reviewing and modifying the Company's proposed PBR plan, the Department was without statutory authority to impose its own monetary penalties for the purpose of enforcing service quality measures.

Second, even where the Department may have discretion to set utility rates at the lower end of a range of reasonableness, such a result has been based on an express finding by the Department of imprudence or unreasonable action on the part of the utility. See Boston Edison Co., D.P.U. 85-266-A/85-271-A at 172-173 (1986); see also Commonwealth Electric Co. v.

Department of Pub. Utils., 397 Mass. 361, 371 (1986); G.L. c. 164, § 94G(b).[7] Under the PBR plan approved by the Department, however, a significant monetary penalty would be imposed on Boston Gas for not meeting service-quality thresholds without substantial evidence or any finding by the Department that a particular service-quality standard was unable to be met as a result of utility mismanagement, unreasonable actions or imprudence.[8] Because the Department is without authority to levy such monetary penalties, the Department's Orders should be set aside. Instead, the Department is limited to imposing service quality penalties only with consent of the Company and only in an amount commensurate with the Company's proposal.

2. There Is No Substantial Evidence To Support a Service Quality Adjustment.

Even assuming, arguendo, that the Department had the legal authority to impose penalties in the Orders, it failed to build a record that would support the imposition of any such penalties as required by the Court. G.L. c. 164, § 14(7)(e); Costello, 391 Mass. at 539. In particular, there is no record evidence cited to support the Department's assertion that the $1.0 million penalty is an inadequate incentive to motivate the Company to meet the SQI benchmarks. In addition, there is no record evidence to support the Department's finding that the penalty provisions adopted by the Department are required to provide such an incentive. There is also no indication in the Orders that the Department-established penalties are based on a specific formula, calculation or cost-benefit analysis, or that the Company's proposal was rejected on the basis of any such

[7] In D.P.U. 85-266-A/85-271-A, the Department expressly found that Boston Edison Company ("BECo") was "neither efficiently nor economically managed." Id. at 172. As a result, the Department determined that BECo's allowed rate of return "should be at the absolute bottom end of the reasonable range." Id. Even having found the presence of inefficient management in BECo, the Department was careful to avoid imposing an unauthorized penalty or setting BECo's return below the reasonable range.

[8] In this manner, the Department's penalties operate as a fine in a strict-liability manner. Pursuant to the Orders, without any finding of fault on the part of Boston Gas, the Department could reduce the Company's rates annually by nearly $5 million, even if there were nothing improper about the Company's performance. The Department lacks statutory authority to impose such strict-liability penalties.

calculation. Therefore, the Department should find that the imposition of a potential service quality penalty of $4.9 million is not warranted.

IV. CONCLUSION

For the foregoing reasons, Boston Gas respectfully requests that the Department find that there is no basis to support the reopening of the record in this proceeding and that the imposition of an accumulated inefficiencies factor and the enlargement of a potential service quality penalty to $4.9 million are not supported by substantial evidence based on the that record.

Respectfully submitted,

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